1. An introduction to entrepreneurial small businesses

Academic interest in small business is relatively recent. Whether the previous lack of interest reflected real-world dominance of big business or simply unawareness of small business by researchers could be debated. More important, however, is that scholars now recognize that small businesses are essential for entrepreneurial activity, innovation, job creation and industry dynamics (Acs, 1992; Thurik and Wennekers, 2001). Evidence from a range of countries shows that since the 1970s, economic activity has moved away from large firms to small firms and at present the majority of new jobs are created by small firms (Davidsson et al., 1994; Thurik and Wennekers, 2001). As a consequence, over the past 25 years, researchers in several academic fields have increasingly become interested in various issues related to small business.

This book is concerned with the growth, performance and entrepreneurial activities of small businesses. While small businesses are not necessarily entrepreneurial, and entrepreneurship also takes place outside of the small business sector, it is clear that the entrepreneurial activities of small businesses are related to outcomes of individual small businesses as well as the economy at large. Small businesses make a substantial entrepreneurial contribution because they are a source of considerable innovative activity, in particular of radical innovation, and are important change agents in the economy (Acs, 1992; Baumol, 1993).

There is also a close relationship between the entrepreneurial activities, growth and performance of small businesses. For a healthy economic development, it is essential that old ideas are replaced by new ones and that old products, services and processes are substituted by those which are better and more effective. New ideas and innovations are often created by new and small businesses that grow rapidly and sometimes even create new industries. Many of the best known and most successful Swedish companies such as IKEA, SKF, Tetra Pak, AGA and Electrolux, were founded and developed upon individual innovations. More recent examples outside of Sweden are Apple, Microsoft and Netscape; all relatively young companies that have grown extremely rapidly and have changed the computer industry. Most people would regard these as examples of exceptional entrepreneurship.
The above discussion implies that entrepreneurship is a key to economic development and also illustrates how closely connected entrepreneurship is to small business growth. In his classic definition of entrepreneurship Schumpeter (1934) stressed that entrepreneurship has to do with combining resources in new ways that create disequilibrium in the economic system. In other words, entrepreneurial firms are innovative to such an extent that they have a substantial impact on the market.

In another well recognized definition of entrepreneurship, Stevenson advocates that pursuit of opportunity is the most important component of entrepreneurship (Stevenson, 1984; Stevenson and Jarillo, 1986; 1990). This definition concerns the business's relation to, and success in, the market place, and realizing what the wants and needs are, and will be in the future. These two definitions complement each other. When combined, entrepreneurship is defined as taking advantage of opportunity by novel combinations of resources in ways which have impact on the market. This is the view of entrepreneurship held throughout this book.

It is hard to imagine a small business taking advantage of an opportunity and having considerable impact on the market place without growing. Let us consider Microsoft for a moment. If Microsoft sold 100 licenses a year, it would neither have any considerable impact on the market, nor would Microsoft take advantage of the opportunity that apparently exists in the computer software market. If we accept the view that entrepreneurship is a matter of degree and not a dichotomous yes or no variable (for example, Stevenson, 1984), expanding Microsoft is at least more entrepreneurial than refraining from doing so. Thus, it seems that growth is an important manifestation of entrepreneurial behavior in small businesses.

THE NEED FOR SYSTEMATIC KNOWLEDGE

As we mention above, there is now considerable academic interest in small business. At the aggregate level, scholars have started to accumulate evidence of the importance of small businesses. Whereas small businesses appear to be a vital part of the economy, the prospect for any individual business is uncertain. Many small businesses die during their first years of operation, or struggle to survive. The number of small businesses that achieve large economic returns for their owners and grow substantially is limited.

Research has revealed that the majority of small firms do not grow, and that many are not even interested in pursuing growth (Storey, 1994; Wiklund et al., 2003). Rapid growth firms are not concentrated in specific industries. Contrary to common belief, these firms may be found in labor
as well as knowledge intensive industries; in manufacturing as well as the service sector (Smallbone et al., 1995; Storey, 1996).

This raises some challenging questions. Is it at all possible to predict which firms will grow, or is firm growth haphazard? Do high performing small businesses share any common characteristics that distinguish them from low performing small businesses? What is the role of entrepreneurship in the growth and performance of small businesses? If we wish to take policy measures to stimulate the development of small businesses, which groups should be stimulated and what type of measures should be taken?

It is important to find out which factors affect the growth and performance of individual small firms. Of particular importance is to identify those factors that could be influenced by small businesses themselves and/or society in general. Knowledge of these factors could form the basis for activities to improve small business performance. It is, for instance, of little or no use to a small business manager to know that the firm would perform better if he or she had a different personality. For the same reason, it is important to find factors that have a sustainable rather than temporary influence on growth and performance.

Unfortunately, our knowledge about these issues is still limited. In recent years several comprehensive lists of studies have been compiled and reviewed. Storey (1994) identified more than 25 growth studies. Delmar (1997) scrutinized the operationalizations of growth used in 55 studies. One of the authors of this book reviewed and classified close to 70 studies for his dissertation work (Wiklund, 1998), while Ardishvili et al. (1998) included in their classification a full 105 published and unpublished studies focusing on new and/or small firm growth.

However, rather than presenting a set of solid generalizations on the causes and effects of growth, these reviewers all tend to come up with relatively critical accounts. These criticisms concern both theoretical and methodological shortcomings. Storey (1994: 5, 125) holds that small firm growth is one of the areas where theorists so far have not made major contributions. As to empirical studies he notes that these have been conducted independently of each other, and that they frequently address issues of specific interest to the researcher in a way that makes comparability with other studies difficult. Cooper (1995: 120) agrees that we need better theoretical frameworks and more theory driven empirical research.

Because the research is so scattered, providing a review of previous findings is likely to provide a mosaic rather than one coherent picture. Therefore, we have instead chosen to address a number of related small business issues in one book. By utilizing a similar theoretical and methodological logic across all chapters and by interpreting our results in a similar
fashion we believe that we are able to present a coherent picture of pertinent small business issues. Empirically, we analyse a number of different samples, thus ensuring that the results obtained are not specific to any particular sample but have greater generality. Most of the research presented in the book has been through the peer review process where other academics judge the scientific quality of the work. This should ensure that the results presented are scientifically valid.

BUILDING OUR UNDERSTANDING OF ENTREPRENEURIAL SMALL BUSINESSES

Definition of a Small Business

When trying to define what a small firm is, it becomes evident that the concept of smallness varies and that there is no single suitable definition of a small firm. It is particularly clear that smallness varies from industry to industry since the size of a company is most often compared to the size of its competitors (Bolton, 1971; Stanworth and Grey, 1991; Storey, 1994). The auto manufacturer SAAB is perceived as being a small company within that industry, whereas not even the largest hairdresser comes close to the size of SAAB.

Basically, there are two different ways of defining small firms. The first type of definition could be labeled theoretical. Criteria for defining a small firm would typically include small market share, personalized management, vulnerability to environmental conditions and non-economic objectives of the manager. These types of definitions are theoretical in the sense that they, based on previous research, presume that small firms are fundamentally different from large firms concerning these dimensions. These fundamental differences provide the rationale for studying small firms as a separate group. One major problem in selecting a sample of small firms based on these criteria is that we do not know if small firms really are fundamentally different until we compare them to large firms, which means that we need a large firm sample for comparison. The other problem is that we would need to do some initial research just to find out whether a particular firm really meets the criteria of smallness and should be included in the sample for further research. Thus, theoretical definitions of small firms lead to very time and resource consuming sample selection.

The second type of definition could be labeled as quantitative. In this case, size itself is the criterion for smallness, and quantitative size data regarding sales, employees or equity are usually used when classifying firms as large or small. The problem with these definitions of small firms is that
they tend to disregard the fact that the small firm sector is heterogeneous
and that smallness varies across industries.

The European Union has proposed a quantitative definition based on
employment (and some additional requirements concerning sales). The
term used is: ‘small and medium enterprise’ (SME). The SME sector is dis-
aggregated into three components:

- Very small enterprises (sometimes referred to as micro-enterprises)
  (0 to 9 employees);
- Small enterprises (10 to 49 employees and annual sales of not more
  than ECU 7 million);
- Medium-sized enterprises (50 to 249 employees and annual sales of
  not more than ECU 27 million).

This is a quantitative definition that takes some of the theoretical aspects
into consideration. According to Storey (1994), one of the advantages of
the distinction of micro-enterprises from small enterprises is that there is a
notable shift in the formality regarding organization and customers at
around 10 to 20 employees which makes micro-enterprises different from
small enterprises. In the research presented in this book, we mainly rely on
this quantitative definition to define small businesses and to select the
samples that we study.

The Role of Strategic Choice

The focus of this book is on the growth and performance of individual
small businesses. Thus, we do not consider population ecology models,
which focus on the death and survival of populations of organizations,
or regional economics studies comparing aggregate performance levels
of small businesses in different locations. Some streams of research (for
example, industrial economics) take a relatively deterministic view of orga-
nizational design and performance outcomes, that is, there is little acknowl-
dedgement that the decisions of the individual can have impact on the
phenomena being investigated. While we agree that there are always some
constraints in any decision making situation, our view is that small business
managers have substantial discretion to exercise choice in the business’s
course of action and therefore can substantially influence small busi-
ness growth and performance. Therefore, our philosophy in writing this
book is that the destiny of the small business is not completely determined
by the characteristics of the environment and other factors outside the
control of the small business but is highly dependent upon the decisions its
management makes.
Furthermore, this book does not take a strict economic rationalist argument where the goal of the small business manager and his/her firm is to always maximize economic profits. Rather, given the attainment of some threshold level of performance, managers may choose to pursue various goals that are not necessarily the maximization of profit. Depending on personal goals, small firms may perform at levels far below their full potential. This view of a manager's discretion is central to the strategic choice approach to understanding growth and performance (Keats and Bracker, 1988).

**The Roles of the Individual, Firm and Environment**

While we do follow the tradition of small business and entrepreneurship research that focuses on the individual we also investigate and integrate other levels of analysis, namely, the firm and the environment. Such an approach has been called for by other scholars in the field (Low and MacMillan, 1988; Zahra, 1993b). Small firms are a particularly suitable area for conducting this type of research (Chandler and Hanks, 1994). Due to their small size, small businesses are not as well insulated from environmental impacts as are larger firms, which makes it all the more important to take into consideration environmental influences.

Due to the business's small size it typically has a relatively simple organizational structure and a relatively homogeneous organizational culture, both of which are dominated by the small business manager and his/her vision. In this sense, we can consider the business and its manager to be very much intertwined. For instance, the manager has a direct and crucial influence on the actions of the small business, whereas in the large firm more people are involved in the decision making process. It is not surprising then that researchers of small businesses focus primarily on the individual (for example, characteristics and decisions) while those that investigate large firms focus more on the firm (for example, corporate culture, organizational reputation, management team, board composition, and so on).

When businesses are new and/or very small, single individuals are responsible for important decisions and actions and there is little need to study entrepreneurial strategy: 'All revolves around the entrepreneur. Its goals are his goals, its strategy his vision of its place in the world' (Mintzberg, 1984; 534). After a firm is established and starts growing, a single individual typically has less influence on the firm and the management becomes more professional; the management team also becomes increasingly important (Stanworth and Grey, 1991). But, at what size does the organization become more interesting than the entrepreneur and vice versa? There is, of course, no such size. Instead, the dual focus on both the
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individual and the organization is needed in research on small businesses. Although we advocate the importance of strategic choice, the environment does play an important role in providing (or not) opportunities for growth and either rewarding or punishing entrepreneurial behavior. Therefore, in this book we consider individual, firm and environmental factors in our explanation of small business growth and performance.

The Resource-Based Perspective

This book is primarily influenced by streams of theory that we collectively label the ‘resource-based perspective’. The most salient characteristic of the resource-based perspective is the focus on the firm’s internal strengths. The resource-based perspective can be traced back to the seminal work by Penrose (1959) on firm growth. However, the perspective has experienced a revival during the 1990s in the strategic management literature. To a great extent this has been a reaction to the analyses of the 1980s, where the focus of strategic management research was on market positioning (Grant, 1991).

The internal resource-based perspective may be particularly suitable when trying to understand why some small businesses perform better and grow more than others. Small businesses do not have the market power to dominate customers and competitors, and therefore market positioning appears less relevant for small businesses. Of course, the environment has profound impact on small businesses and it is essential for them to pursue the opportunities that arise in the environment. However, we argue that the way in which this is done is determined by internal characteristics. For example, as we show in Chapter 2, the human capital and motivation of the small business manager has profound effect on subsequent small business growth. Irrespectively of whether or not profitable opportunities arise in the environment, unless the small business manager has the capacity and aspirations to pursue these opportunities growth will not occur.

Further, previous studies have found that the resources that small businesses control or have access to are important for their capacity to grow and perform well (see Wiklund, 1998, Appendix 1, for a review of this literature). Several strands of resources have been studied such as financial capital, start-up experience, education level of the small business manager and of employees, and so forth. The resource-based perspective provides a solid theoretical embedment for such findings and offers explanations as to why those small businesses that can access particular resources acquire an advantage over other small businesses, which allows them to grow and perform well. In this book, we examine several strands of resources, that is, the human and social capital of the small business manager, the marketing
and technological knowledge of staff, the access to financial capital (debt and equity) and how they contribute to the entrepreneurial activities, growth and performance of small businesses. The resource-based perspective provides us with an overarching theoretical framework for hypothesizing about these relationships and interpreting our empirical findings.

LAYOUT FOR THE REST OF THE BOOK

Chapter 2 focuses on ‘The motivation to grow a small business’. This chapter takes an important step towards an increased understanding of a small business manager’s growth aspirations and the actual growth achieved by his or her small business. While there is a positive relationship between the aspiration for, and the achievement of small business growth, the relationship is more complex – it depends on the resources of the small business manager and opportunities for growth that exist in the environment. Specifically, education, experience and environmental dynamism magnify the positive effect that growth aspirations have on the realization of small business growth. In this chapter we also acknowledge that 1) while some people have the motivation to grow their business they may not have the capability to do so and 2) while some people have the capability to grow their businesses they may not have the motivation to do so.

Chapter 3 focuses on ‘Who grows small businesses and how they choose to do it’. This chapter explores differences in small business managers in terms of their own personal resources (human capital) and their access to resources (social capital) as a means of distinguishing those who engage in subsequent entrepreneurial activities from those who do not and also as a means of distinguishing between the modes used to exploit these subsequent entrepreneurial activities. We find that human capital (education and start-up experience), and social capital (business network and relational density) are important resources in explaining whether small business managers engage in subsequent entrepreneurial activities or not. We also find that one type of resource is associated with a particular mode for organizing the entrepreneurial activities.

Chapter 4 focuses on ‘The small business’s entrepreneurial orientation and knowledge-based resources’. We explore the performance implications of a small business’s knowledge-based resources focusing on those that are applicable to the discovery and exploitation of opportunities. We also explore the performance implications of a small business entrepreneurial orientation, where entrepreneurial orientation represents how the numerous components of a small business are organized in order to discover and exploit opportunities. We find that the way that a small business is
organized (its entrepreneurial orientation, or EO), can enhance the positive relationship between knowledge-based resources and small business performance. We argue that those small businesses with considerable knowledge-based resources know where to look for opportunities, can more accurately assess the value of potential opportunities, and have the ability to extract value from these opportunities, but unless the firm is organized to grasp and enthusiastically pursue these opportunities, then the knowledge-based resources are likely to be underutilized.

Chapter 5 focuses on ‘The small business’s entrepreneurial orientation, financial capital, and the environment’. This chapter further explores small business performance through the concomitant consideration of EO, resources internal to the small business (access to capital), and resources external to the small business (environmental dynamism). The nature of the configurations suggests that businesses that face performance constraints, in terms of a stable environment and limited access to capital, can be superior performers if they have a high entrepreneurial orientation (EO). This finding is consistent with the saying that ‘necessity is the mother of invention’. It appears that a high EO provides businesses with the ability to find and/or discover new opportunities that can differentiate them from other firms and create a competitive advantage. When the environment is dynamic and the firm has considerable access to capital, it appears that small business performance might be improved by a more inwardly focused orientation that better capitalizes on these abundant opportunities by focusing on efficient exploitation.

Chapter 6 focuses on ‘Venture capitalists’ investment decision policies and maintaining a good relationship’. With the help of Andrew Zacharakis, we use theory from the resource-based view (RBV) of strategy to investigate venture capitalists’ (VCs’) decision policies when assessing the likely performance of potential portfolio companies. We find that venture capitalists value those businesses that 1) have a proprietary technology, 2) have a management team with market familiarity, 3) are in a fast growing market, and 4) have a management team that have considerable general leadership skills. Although venture capitalists always prefer greater general experience in leadership, they value it more highly in large markets, when there are many competitors, and when the competitors are relatively weak. We also find that previous start-up experience of the business’s management team may substitute for leadership experience. Understanding venture capitalists’ decision policies may help small businesses to access equity capital to pursue growth opportunities. There are numerous benefits to a business that can establish a long term relationship with a venture capitalist and in this chapter we explore how small business managers can better manage this relationship. The entrepreneur and the VC need to
balance the level of control and trust building mechanisms so that the optimal level of confidence in partner cooperation can be achieved. We propose that the entrepreneur can build trust with the VC (and vice versa) by signaling commitment and consistency, being fair and just, obtaining a good fit with one’s partner, and with frequent and open communication. Open and frequent communication acts as a catalyst for the other trust building mechanisms.

Chapter 7 focuses on ‘Loan officers’ decisions policies towards small businesses’. Loans from banks represent an important funding source for small businesses. Along with Volker Bruns, we investigate the decision policies of loan officers in their assessments of small business loan requests. We find that loan officers are more likely to provide a small business loan if that business’s past performance had been high and/or the business’s competence was related to the project for which funding was required. The findings also suggest that project risk decreased the likelihood of a loan officer granting a loan for those small businesses with weak financial standing, but had little or no impact on those small businesses with strong financial standing. Similarly, project risk decreased the likelihood of a loan officer granting a loan to those small businesses with collateral dependent on the success of the project, but had little or no impact on those small businesses that were able to offer collateral independent of project success. We also explore differences in loan officers’ human capital to explain differences in their decision policies.

Chapter 8 focuses on ‘Learning from small business failure’. In the pursuit of entrepreneurial outcomes there is the risk that the business will fail. This chapter employs the psychological literature on grief to explore the emotions arising from business failure. It suggests that the loss of a business due to failure can cause the small business manager to feel grief, which is a negative emotional response interfering with the ability to learn from the events surrounding that loss. Recovering from grief involves dealing with the loss, avoiding thinking about the loss, or a dual process that iteratively combines these two approaches. A dual process provides the speediest path to grief recovery enabling small business managers to learn more from the events surrounding the loss of the business owing to a lack of emotional interference. But even in the presence of grief, a dual process minimizes emotional interference enhancing the ability of small business managers to learn from the loss of a business. An improved ability to learn from business failure is important for individuals and society. We then challenge educators to prepare students better so that if they do become small business managers and their small business fails they can recover more quickly from the negative emotions associated with the loss of the business.

Chapter 9 concludes the book.
APPROPRIATE AUDIENCE FOR THE BOOK

We hope the audience for the book is broad. We do not ‘shy away’ from its academic origin, with all chapters based on research articles that have been or will shortly be published in academic journals. We believe that this highlights the cutting-edge nature of the information contained within the book. But we also realize that academic jargon, especially associated with research methods, can be off-putting and unnecessary for small business practitioners. To accommodate scholars and practitioners, we have included in the text of each chapter only a description of the sample and the results of the empirical study with other aspects of the research method contained within an appendix at the end of the chapter. This provides scholars the opportunity to delve deeper into the scientific aspects of the study and allows the practitioner to either learn about the sample and the results (written in a less academic tone) or skip the section completely. Following each section of ‘sample and results’, we present the results again in the form of general rules of thumb that will be of interest to both practitioners and scholars. Therefore, to practitioners, professors, PhD students, MBA students and senior undergraduates this book offers cutting-edge material about entrepreneurial small businesses. They may focus on the practical implications of the chapters, the literature reviewed, or the possibilities for future research.

We hope they enjoy the book as much as we did researching and writing it.